Ann Misback

Secretary, Board of Governors of the Federal Reserve System

Constitution Ave NW & 20th St NW

Washington, DC 20551

Via: Email to *regs.comments@federalreserve.gov*

February 6, 2023

Re: Statement of Principles for Climate-Related Financial Risk Management for Large Financial Institutions, Docket No. OP-1793

Dear Ms. Misback,

On behalf of the 69 undersigned organizations and our millions of members and supporters, we welcome the opportunity to comment on the Statement of Principles for Climate-Related Financial Risk Management for Large Financial Institutions published by the Federal Reserve Board of Governors of the Federal Reserve System (FRB). We support this important step toward advancing financial institutions' efforts to assess and address climate-related risk, and urge the FRB to strengthen and finalize the draft as soon as possible.

Climate change poses significant risks to the safety and soundness of financial institutions, the financial system, and communities. We support the FRB's recommendations for large financial institutions to take a whole-of-business approach to mitigating climate risk, to consider longer time horizons for assessing and addressing climate risk, and to develop climate-related data and scenario analysis modeling. We also welcome the provisions directing these financial institutions to align their internal strategies with their public climate commitments; this is important to maintain safety and soundness and promote financial system resiliency. We also support recommendations for banks to recognize the fair lending implications of their risk-management measures and their adverse effects on low-income and other disadvantaged households and communities.

Nevertheless, we are concerned that the Statement does not directly (1) acknowledge the need for credible net-zero transition plans and provide clarity around what it means for large financial institutions to align their climate commitments to their internal strategies, and (2) indicate that climate change threatens not only large U.S. financial institutions but also smaller financial institutions—including, for example, state member banks regulated by the FRB—with implications for access to finance by low- and moderate-income (LMI) and other vulnerable communities. The Statement should recognize that large financial institutions fuel climate risk through their financing and facilitating of greenhouse gas (GHG) emitting activities. This recognition will lay the groundwork for the FRB to cooperate with other federal banking regulators to take action to protect the safety and soundness of these entities and the banking system.

The FRB should treat these principles as a first step, and quickly issue additional more detailed guidance on how banks can implement the expectations they contain, and otherwise address other concerns outlined below.

Ensuring alignment of climate commitments and strategies

We welcome the provision directing financial institutions to ensure that their internal strategies are consistent with their public statements, given that many large U.S. financial institutions have publicly committed to creating and executing net-zero transition plans. As transition risks for these large institutions are heightened by policy change, such as massive incentives for renewables provided by the Inflation Reduction Action Act, by technological change, and by public demand, credible plans for large banks become even more important. To date, however, most large bank plans will not achieve a promised net-zero transition.

Many U.S. banks have made commitments to "net-zero" emissions by 2050, including joining the bank-led Net-Zero Banking Alliance (NZBA) initiative under the Glasgow Financial Alliance for Net Zero (GFANZ). These banks have not established strategies to meet their commitments, and they continue engaging in actions inconsistent with them. Financial institutions are continuing to finance new fossil fuel infrastructure, other high-emitting projects, and the companies expanding high-emitting activities. This financing is not compatible with reaching net-zero emissions by 2050 or limiting global temperature rise to 1.5°C. This conduct raises questions about whether financial institution management understands which of the bank's assets are exposed to transition risk, or if management can effectively implement the plans needed to achieve a strategic objective. To meet its public commitments, a financial institution's corresponding actions and internal strategies must be grounded in climate science and technological realities.

The FRB should clarify what it means in practice for large financial institutions to align their net-zero transition plan commitments with their internal strategies. Among the most significant parameters to expand on are (1) providing measurable near-term milestones based firmly in climate science and technological realities; (2) aligning financial institution financing decisions with the institution's own commitments to net-zero emissions; and (3) accurately accounting for the challenges posed by offsets.

In addition, the FRB should explain that, regardless of whether banks have made public commitment to reduce financed emissions, establishing a science-aligned transition plan is an effective and increasingly important way to reduce transition risk, as well as physical risk in the longer term.

Measurable Milestones

The FRB should make clear that financial institutions committing to net zero by 2050 must have in place, and must implement, credible internal strategies that meet the imperatives of climate science, technological realities, and safety and soundness. A credible plan in line with public commitments includes short- and medium-term targets and metrics. Such milestones are critical not just to meeting the commitments, but also to avoiding a fire sale from financial institutions trying to meet their commitments at the last minute. A credible plan should include milestones in line with the developing global consensus from organizations like the NZBA, such as a 50% reduction in absolute financed emissions by 2030, and should be publicly available.

Aligning Financing Activity to Emissions Reductions Targets

The expansion of fossil fuel production is not compatible with any science-based limit on global temperature rise or with meeting public commitments for net-zero financed emissions by 2050. Key tenets of the International Energy Agency's 2021 roadmap for achieving net-zero emissions by 2050 include no investment in new fossil fuel supply and no new unabated coal plants. Yet as indicated by the recent Banking on Climate Chaos report, U.S. financial institutions are the most significant financiers of fossil fuels globally, and they have continued to increase their funding despite voicing their support for the Paris Agreement and committing to net zero by 2050. These contradictions raise serious questions about the sincerity of financial institutions' climate commitments or, alternatively, the soundness of their management processes and controls.

To meaningfully align their internal strategies and public commitments, financial institutions need to switch to a science-based approach to meeting their absolute emissions reduction targets. We urge the FRB to work with the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC) to adopt a consistent approach to overseeing alignment of climate commitments in line with these recommendations.

Offsets

Some institutions may seek to rely heavily on purported "offsets" of carbon emissions from forests, wetlands, and carbon removal technologies to achieve net-zero carbon emissions. But offsets have such deep limitations that they cannot be relied on to play more than a trivial role in any credible net-zero plan. The limitations include difficulties quantifying or verifying avoided or reduced emissions, questions about the effectiveness and permanence of natural sinks that may be threatened by human or natural impacts, concerns about the reliability and legal norm compliance of promised reductions due to violations of indigenous rights and treaties, the lack of technologies that are credible and dependable, and the potential for fraud. For these reasons, climate commitment standard setters are increasingly treating offsets as only a last resort to negate residual emissions that remain after financial institutions have directly reduced financed emissions as near to zero as is possible.

Questions about the integrity of offsets have stymied efforts by Mark Carney and others to advance the carbon offset market and have prompted the Commodity Futures Trading Commission to begin examining the integrity of offset-related claims. Given these challenges, regulators should understand how bank management is assessing offsets as part of their climate commitments, and whether reliance on offsets for reductions of more than a residual level of emissions reveals undue credulity regarding dubious scientific and technological claims.

Ensuring fair access to financial services

We welcome the FRB's attention to potential fair lending concerns that could occur when large financial institutions reduce their own exposures to climate-related credit and other financial risks. Financial institutions are increasingly likely, for example, to reduce financing in hotspot areas and for assets threatened by climate-related extreme weather events, following the lead of insurers who are exiting or raising the price of coverage in these areas. Costs related to financing in these areas are likely to increase, which will hinder these communities' ability to recover and adapt, further entrenching climate-exacerbated racial and economic inequalities.

Still, by restricting these principles to risk management at the largest banks, this proposal fails to recognize that access to lending is impaired not only by measures by large financial institutions to manage their own risks, but also by the increasing number of weather events that threaten smaller financial institutions—events that are fueled by large financial institution financing and underwriting of high emissions activities.

The FRB is mandated to ensure the safety and soundness of not only large financial institutions, but also numerous regional and community banking organizations that are critically important for LMI communities in the U.S., as well as the stability of the entire financial system. These banks constitute the largest number of banking organizations supervised by the FRB.

These banks are more vulnerable to regionally concentrated physical risk, including sudden extreme weather events, due to their size, their focus on agriculture, residential, and commercial real estate lending, and their reduced ability to move or shift portfolios. One federal advisory committee observed that climate-related shocks to communities and, in turn, to community and regional banks, are creating a systemic crisis in slow motion.

The Statement should recognize that orderly reductions in financing and support for GHG-related activities are a necessary component of managing system-wide financial risk and would meaningfully reduce safety and soundness for many financial institutions—large and small—as well as the risks of impaired access to financial services for all communities.

Clarifying the continuing importance of stakeholder expectations and reputational impacts

The FRB should clarify that the requirement to consider climate-related risks impacts on stakeholders includes impacts on stakeholder expectations and the institution's reputation, as the OCC and FDIC proposals do.

Continuing with necessary next steps

These draft principles are much delayed compared to the efforts by the OCC and the FDIC, and they are much vaguer than the detailed expectations laid out by global peers and the Basel Committee on Banking Supervision. Keeping in step with these international developments will promote financial stability by preventing regulatory arbitrage. The FRB should finalize these principles quickly and follow them with additional guidance and regulatory measures that detail a full set of expectations for all banks.

Areas for more detailed supervisory guidance include the following:

1. Implementation of the Basel Committee recommendations on capital adequacy and incorporating a margin of conservatism.
2. Guidance on how examiners will review alignment of public climate commitments with internal strategies, and what examiners will expect when assessing banks' plans to meet their climate commitments or transition plans that they craft simply to manage risk (if a bank has committed to a science-based or Paris-aligned emissions pathway, then there may be little difference between the two types of plans).
3. Details on how financial institutions can provide credit to vulnerable communities equitably in a safe and sound manner, and how they can identify, measure, monitor, and address potential and actual disproportionate impacts to communities of color and low-moderate-income communities.
4. Expectations for how the FRB will understand and address the risks that financed emissions create for all financial institutions and financial stability.

Conclusion

The U.S. lags behind much of the world on mitigating climate-related risk. We encourage the FRB to take the lead with its global peers who are actively exploring the need for additional supervisory and regulatory measures to respond to climate risk, including the need for increased attention to capital and liquidity requirements at the largest, most complex institutions.

We look forward to continuing to engage with you on these issues.

For questions, please contact Anne Perrault at aperrault@citizen.org and Yevgeny Shrago at yshrago@citizen.org.

Sincerely,

Public Citizen
Accelerate Neighborhood Climate Action
Action Center on Race and the Economy
Amazon Watch

Americans for Financial Reform Education Fund
Bold Alliance
Businesses for a Livable Climate
California Reinvestment Coalition
Call to Action Colorado
CatholicNetwork US
Connecticut Citizen Action Group
Center for International Environmental Law
Citizen's Alliance for a Sustainable Englewood
CO Businesses for a Livable Climate
Community for Sustainable Energy
Divest Oregon
E3G
Earth Action, Inc.
Earthworks
Endangered Species Coalition
FreshWater Accountability Project
Greenpeace USA
I-70 Citizens Advisory Group
Indivisible Ambassadors
Institute for Agriculture and Trade Policy
Larimer Alliance for Health, Safety and Environment
League of Conservation Voters
Littleton Business Alliance
Louisiana Bucket Brigade
Mayfair Park Neighborhood Association Board
Mental Health & Inclusion Ministries
Montbello Neighborhood Improvement Association
North Range Concerned Citizens
Greater New Orleans Housing Alliance
Oil & Gas Action Network
Positive Money US
Presente.org
RapidShift Network
Regenerating Paradise
Revolving Door Project

Rise St. James
Rivers & Mountains GreenFaith
Save EPA (former employees)
Sierra Club
Small Business Alliance
Southwest Organization for Sustainability
Spirit of the Sun, Inc.
System Change Not Climate Change
The Green House Connection Center
The Greenlining Institute
The Sunrise Project US
The Vessel Project of Louisiana
Transformative Wealth Management, LLC
U.S. PIRG
Union of Concerned Scientists
Unite North Metro Denver
Wall of Women
Waterway Advocates
Western Slope Businesses for a Livable Climate
Womxn from the Mountain
Working for Racial Equity
World Wildlife Fund
350 Colorado
350 Conejo / San Fernando Valley
350 Silicon Valley
350 Wisconsin
350.org
350 Juneau
350 MoCo